

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
E. J. AND VIRGINIA S. COLLEY)

For Appellants: Diana C. Watega

For **Respondent:** Jon Jensen
Counsel

O P I N I O N

This appeal is made pursuant to section 19057, subdivision (a), of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of E. J. and Virginia S. Colley for refund of personal income tax in the amount of \$13,625.96 for the year 1974.

Appeal of E. J. and Virginia S. Colley

The sole issue is whether respondent has **properly determined** the fair market value of certain timber as of January 1, 1974, for Revenue and Taxation Code section 17711 purposes.

Section 17711 is an elective provision which allows a taxpayer to treat the cutting of timber during a taxable year as a sale or exchange of a capital asset. When this **election** is made, gain or loss is recognized by the taxpayer in an amount equal to the difference between (1) the fair market value of the timber as of the first day of the taxable year in which such timber is cut, and (2) the taxpayer's adjusted basis for depletion of the timber.

Appellant-husband (hereinafter "appellant") owns and operates the E. J. Colley Logging Company located in **Redding, California**. Pursuant to a contract with the Paul Runyan Lumber Company (hereinafter "Bunyan") dated April 30, 1973, appellant agreed to sell logs to Bunyan in 1973 and 1974 at a sales **price** per thousand board feet as follows: **(1) stumpage, \$58^{1/2} plus** market adjustments; **(2) logging, \$22,** and **(3) hauling,** in an amount to be agreed upon. On his 1974 personal in-come tax return, appellant elected to use the provisions of Revenue and Taxation Code section 17711 to report as capital gain the difference between the adjusted basis of the timber sold in 1974 and its fair market value on January 1, 1974. Appellant reported a January 1, 1974, fair market value of \$76 for some of the timber and \$54 for the remainder.

Respondent agrees that appellant is entitled to elect section 17711 treatment but contends that the fair market values that appellant has used are in error. **Applying** the terms of the Bunyan contract, respondent determined that the "standing value" of the subject timber was \$40.15 **as of** January 1, 1974. Briefly, **respondent computed** that **figure by applying the market adjustments to the stumpage** figure of \$58. Respondent contends that this figure is what a willing seller and a willing buyer had agreed was the selling price as of that particular date, and that the figure constitutes, by definition, fair market' value for section 17711 purposes.,

1/ All dollar values are expressed in terms of thousand board feet.

Appeal of E. J. and Virginia S. Colley

Appellant, on the other hand, has produced a letter appraisal by a firm of consulting foresters, which states **that the** value of the **stumpage** as of January 1, 1974, was between \$80 and \$85. This, of course, would support appellant's position.

As indicated above, the **sole** issue for our determination is the fair market values of the subject timber as of January 1, 1974. This is a case of **first** impression before this board. **However**, section 17711 is similar to its federal counterpart. (Int. Rev. Code of 1954, § 631.) **As** there are no regulations of the Franchise Tax Board interpreting section 17711, pursuant to the authority of section 19253. of the Revenue and Taxation Code, regulations under the Internal Revenue Code would govern the interpretation of the conforming state statute. (Cal. Admin. Code, tit. 18, reg. 19253.) Moreover, cases interpreting section 631 are highly persuasive as to the proper application of section 17711. (Holmes v. McColgan, 17 Cal.2d 426 [110 P.2d 4281 (1941)]; Union Oil Associates v. Johnson, 2 Cal.2d 727 [43 P.2d 2911 (1935)]; Meanley v. McColgan, 49 Cal.App.2d 203 [121 P.2d 45] (1942).)

Respondent's position appears to be grounded upon the proposition that "fair market value of . . . timber" for section 17711 purposes is limited by the terms of the Bunyan contract. Briefly, respondent argues that the timber cutting **contract** between appellant, a willing seller, and **Bunyan**, a willing buyer, by **definition**, establishes what the fair market value of that timber was as of January 1, 1974. Accordingly, respondent looked only to the **stumpage** element of that contract and applied the appropriate market adjustments to determine that the fair market values in question **were \$40.15** as of January 1, 1974.

However, respondent's position not only ignores what the practical effect of the logging and hauling elements might **have** upon fair market value, but also ignores Revenue Ruling 74-271, 1974-1 Cum. **Bull.** 151. Revenue Ruling 74-271 held that the terms of a contract under which the taxpayer acquired **the unrestricted right** to cut and use timber in its **lumber** manufacturing business are not relevant in determining the fair market value **of** timber cut for purposes of section 631(a) of the Internal Revenue Code. Accordingly, that contract between a willing buyer and willing seller applying a formula, for computing **stumpage** payments was ignored **for section 631(a)** purposes. Instead, it was held that the fair market **value** of the

Appeal of E. J. and Virginia S. Colley

timber was to be determined under the objective standards set forth in sections 1.631-1(d)(2) and **1.611-3(f)** of the Treasury Regulations. While regulation section 1.631-1(d)(2) does give lip service to the willing buyer-willing seller concept, it further provides that due consideration is to be given to the regulations under section **611** of the Internal Revenue Code. Regulation section 1.611-3(f), in turn, provides that fair market value will be determined by such factors as: (1) character and quality of the timber, (2) quantity of timber per acre, (3) accessibility of the timber, and (4) freight rates by common carrier to important markets. As can be seen, logging and transportation costs can be factors in determining the fair market value of **timber**. **Accordingly**, respondent appears to be remiss in ignoring the effect of logging (\$22) and hauling costs (to be determined) in computing the fair market value of the timber for section 17711 purposes,

This being the case, and taking into account these extra elements of value, we find the appraisal letter submitted by appellants to be convincing. (Appeal of St. Francis Hotel Corporation, Op. on Reh., Cal. St. Bd. of Equal., Aug. 7, 1963.) **Accordingly**, we hold that respondent's **action** must be reversed.

Appeal of E. J. and Virginia S. Colley

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of E. J. and Virginia S. Colley for refund of personal income tax in the amount of **\$13,625.96** for the year 1974, be and the same is hereby reversed.

Done at Sacramento, **California**, this 5th day of April, **1984**, by the State Board of Equalization, with Board Members **Mr. Nevins, Mr. Dronenburg, Mr. Bennett** and **Mr. Harvey** present.

<u>Richard Nevins</u>	, Chairman
<u>Ernest J. Dronenburg, Jr.</u>	, Member
<u>William M. Bennett</u>	, Member
<u>Walter Harvey*</u>	, Member
<u></u>	, Member

*For Kenneth Cory, per Government Code section 7.9